

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Pricing and Procurement of Default Service) D.T.E. 99-60

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COMMENTS OF COMPETITIVE RETAIL SUPPLIERS AND AGGREGATORS

I. INTRODUCTION

Enron Energy Services, Essential.com, Exelon Energy, GreenMountain.com, and Utility.com (together "Competitive Retail Suppliers and Aggregators") are pleased to offer the following comments in response to the questions posed in the Department's May 12th Order regarding default service. Pricing and Procurement of Default Service, D.T.E. 99-60-A (May 12, 2000).

In general, the Competitive Retail Suppliers and Aggregators would like to offer their strong support for the improvements to default service pricing outlined in the Department's Order. In particular, we applaud the proposed change to retail default service prices that reflect actual *market* prices, as opposed to *negotiated* prices that bear no relation to current market conditions. This is the first and most important step in fixing default service pricing.

As the Department is well aware, the current system of default service pricing is seriously flawed. After twenty-four months of competition, just 0.3% of Massachusetts customers have switched to a competitive supplier. Massachusetts Division of Energy Resources, *Customer Migration Data* (as of February 29, 2000). By contrast, in Pennsylvania, 10.2% of customers switched in just 15 months. Pennsylvania Office of Consumer Advocate, *PA Electric Shopping Statistics* (as of April 1, 2000).

II. RESPONSES TO QUESTIONS

Question 1: Are there data that demonstrate that the costs associated with providing default service will differ significantly among customer classes? If so, please provide a full description of such data and discuss the manner in which customer classes can or should be differentiated for the purpose of establishing different default service prices. Would such differentiation be consistent with or offensive to the statutory scheme for restructuring the electric industry?

Yes, there are data that demonstrate that the costs associated with providing default service will differ significantly among customer classes. Indeed, as was discussed at the technical session on May 25th, the Department has recognized for decades that the cost of serving customers varies by customer class and has accordingly approved rates that vary by customer class.

Moreover, virtually every other state with a competitive electric market has established a default service prices that vary by customer class. We have attached an exhibit that shows "default service" ⁽¹⁾ prices in effect today at utilities in five states: California, Maine, Connecticut, Pennsylvania, and New Jersey. In every case, the prices vary by customer class.

The California prices are particularly instructive. California has separate default service prices for each rate class. The calculation of these prices begins with the hourly Power Exchange or "PX" price. However, the utilities' cost of generation does not equal the straight PX price. Instead, the utilities' cost is the PX price adjusted for a number of factors, including customer load profiles and line losses. ⁽²⁾ The California utilities make these adjustments on a rate class specific basis, and thus create a set of rate class specific prices that reflect the utilities' cost of generation for those rate classes. See, e.g., San Diego Gas and Electric Company, *Schedule PX: Power Exchange Energy*, Revised Cal. PUC Sheet No. 12727-E (August 12, 1999) (available on the web at http://www.sdge.com/EIC/html/loss_factors.htm)

The California prices vary significantly by rate class. Exhibit 1 includes a representative sample of the most recent set of prices posted by San Diego Gas and Electric. There, prices for small C&I customers are nearly 11% higher than prices for residential customers. See Exhibit 1.

The Maine experience is also instructive. In Maine, default service power is procured competitively through a process similar to the one outlined in the Department's May 12th order. One key difference, however, is that in Maine the power is procured separately by customer class. A second key difference is that the Maine Commission conducts the procurements rather than the utilities.

The Maine's procurement process for this year was not a complete success; the Maine Commission was unwilling to accept the prices produced by the market and rejected all bids for some customer classes in some territories as "too high." The Commission then directed the utilities to procure the power for default service customers. Maine Public Utilities Commission, Summary of Standard Offer Bids, Docket No. 99-111 (February 1, 2000).

However, imperfect as it was, the Maine process did produce default service prices for all customer classes that reflect the differing costs of serving those classes. For example, at Maine Public Service, the one utility for which the Commission's bidding process produced acceptable bids for all customer classes, there is a 7.3% difference between the highest priced class and the lowest priced class. See Exhibit 1.

While there is substantial evidence that the cost of providing default service varies by customer class, it is not necessary or even desirable for the Department to set class-specific prices. Instead, we should allow the market to make this determination. The Department should direct the utilities to solicit separate prices by customer class when they procure default service power.⁽³⁾ The utilities should then establish class-specific retail default service prices based on the bids that they receive. Then, the market will determine whether and to what extent prices should vary by class.

We recommend that the utility solicitation seek price bids for at least three customer groupings as in done in Maine: 1) residential and small commercial; 2) medium non-residential; and 3) large non-residential. We do not recommend separate price bids by rate class. Although rate-class specific bids would increase the level of pricing precision, it might make the customer groups too small for an efficient wholesale procurement.

Differentiating default service prices by customer class is consistent with the statutory scheme for electric restructuring. The statute is silent on this point: it does not state either that default service prices should be the same for all customer classes or that they should vary. M.G.L. Ch. 164, § 1B(d). However, the statute was enacted against a background of electric rates that varied by customer class, and indeed had varied by customer class for decades. Hence, in the absence of a specific prohibition, it is reasonable to read the statute as allowing rates that vary by customer class.

The only statutory limit on the default service rate is that it must not "exceed the average monthly market price of electricity." Id. Were there such a market price, there is no question that it would vary by customer class because the cost of serving customers varies by customer class. Even if Massachusetts had a single benchmark price such as the California PX price, that price would not constitute a single "market price" for retail customers. This is because retail customers do not buy power at the PX price. Instead, the closest they come is buying at the PX price adjusted for customer load shape and line losses. Making these customer class specific adjustments to the PX price produces a set of customer class specific "market prices." As is described above, this is exactly what is done in California.

Question 3: Are the distribution company's overhead and administrative costs per KWH associated with providing default service expected to be significant when compared to the bid price for default service? If the number of customers on default service increases significantly either during the transition period or at the end of the transition period when standard offer service is terminated, how would these overhead and administrative costs per KWH be affected?

All appropriate administrative and overhead costs, no matter how small, should be included in the default service rate. These costs include the direct costs of procuring default service supply and negotiating and administering the resulting contracts. They also include a portion of additional utility costs, including regulatory expenses, credit and collections, bad debt, customer service, and administrative and general costs. Further, at the technical session, the utilities identified additional costs associated with providing default service, including customer education and costs to modify billing systems to enable them to bill a different rate structure.

Although these costs seem small, they are significant when compared to the gross margins yielded by a sale to a customer. Competitive electric supply is a very low margin business. In addition, the Department should order the utilities to include these costs to the default service charge to be consistent with its own ratemaking principles. To forgo adding them to the charge in this proceeding because they are small will open the door to challenges of any charge in future proceedings before the Department due to the charge's perceived significance or insignificance.

Question 4: If a distribution company's overhead and administrative costs associated with providing default service were to be included in the price for default service paid by customers, how should these costs be estimated? Can these costs be quantified only in the course of a rate case proceeding?

Until such time as the utilities go to the Department for rate review, the Department should establish a set of accounts and allocation proportions to apply to the development of the default service rate from each company's annual return to the Department or from its latest test year cost of service. In order to prevent these costs from being collected twice, utilities should credit revenues from this adder back to all firm customers through a distribution adjustment charge. New incremental costs not included in base rates, such as customer education and systems modifications, can be included to the administrative adder without crediting the revenues back to all customers in the distribution adjustment charge.

Question 5: Does the Department's proposal sufficiently address concerns that competitive suppliers may seek to shift their customers to default service during peak months when the default service price is lower than prices available in the wholesale energy market? Are there ways that the proposal could be revised to better address these concerns?

We recommend that the Department's proposal be modified to give residential and small commercial customers a single default service pricing option -- a fixed, six-month price - rather than the two options described in the proposal.[\(4\)](#)

We understand that the rationale for the second pricing option - a price that varies monthly - is to limit the ability of customers to exploit differences between default service prices and market prices by moving back and forth between the two. We recognize that this is a legitimate concern regarding larger customers, and believe that the Department's proposal will address it.

Fortunately, there is far less reason to be concerned about "gaming" by smaller customers. Gaming has not been a common practice among these customers to date, and there is little reason to believe that it will become one. For the vast majority of small customers, the transaction cost of moving back and forth between default service and competitive supply would exceed the savings to be gained from the price differential.

However, giving small customers two default service pricing options would create other problems.

First, it would cause customer confusion and make it more difficult to market competitive supply to those customers. Because small customers generally do not know what price they pay for electricity, retail marketers typically price their offerings using the utility price as a benchmark. For example, most marketers offer a "percentage off" the utility price. Many green power marketers sell green products either "at no more than" the utility price or at a specified amount above the utility price.

However, this "benchmark pricing" will become more difficult for marketers and more confusing for customers if all default service customers within a service territory are not paying the same price for default service. Indeed, simply splitting standard offer and default service pricing will already create a great deal of complexity. Creating a second default service price would add to the problem significantly.

Further, creating two default service prices greatly increases information tracking requirements for the utilities. At the technical session, the utilities indicated that their existing information systems are not capable of providing two separate default service rate options. The capability can no doubt be added to those systems, but at a cost. It is not necessary to incur this cost for smaller customers since gaming is unlikely to be a problem with those customers.

Finally, creating a second default service pricing option makes it more difficult for retail marketers to compete with the utility service. Default service should be plain vanilla. We should let the competitive market offer the other flavors.

Respectfully submitted,

ENRON ENERGY SERVICES

By

Frank Rishe

Manager, State Government Affairs

GREENMOUNTAIN.COM

By

Carrie Cullen Hitt

Director - Regional Development

343 Thornall St., 5th Fl.

Edison, NJ08837

tel: (732) 548-1234 x223

e-mail: frishe@ees.enron.com

ESSENTIAL.COM

By

Chris Kallaher

Vice President, General Counsel

3 Burlington Woods

Burlington, MA 01803

tel: 781-229-9599 x146

e-mail: ckallaher@essential.com

EXELON ENERGY

By

R. Scott Brown

VP Business Development

2600 Monroe Boulevard

36 Sparks St., Suite 1

Cambridge, MA 02138

tel: (617) 492-7157

e-mail: hitt@greenmountain.com

UTILITY.COM

By

Paul Gromer

c/o Peregrine Energy Group

77 North Washington St.

Boston, MA 02114

tel: 617-367-0777 x28

e-mail: pgromer@peregrinegroup.com

Norristown, PA 19403

tel: (610) 676-8160

e-mail: rbrown@exeloncorp.com

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1. 1 We use the term "default service" generically to mean generation service provided by the distribution utility. Each state has its own name for the service.

2. 2 The PX prices are also adjusted for uplift charges and an uncollectibles expense factor. However, these adjustments do not vary by rate class.

3. 3 Our recommendation does not require that the utilities issue separate RFPs for each class, merely that they ask the bidders for separate prices. Nor does our recommendation preclude the utilities from choosing a single bidder to supply the power for all customer classes.

4. 4 Some signatories to these comments would prefer that the sole pricing option be monthly prices because monthly prices more closely reflect market prices. However, we understand that the Department interprets M.G.L. Ch. 164, § 1B(d) to require a six-month price option. All signatories prefer that there be just one pricing option, even if that option is a six-month price rather than a monthly price.